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Are Fractional Ownerships Coming Back?

By Carrie Rossenfeld

Farahnik: "With the DST structure, the field of properties is limited to single-tenant or multifamily."

LOS ANGELES-The increasing number of would-be commercial real estate **investors** is making available properties harder to find. Even in today's market, smaller investors may need help finding properties in which to invest. As a result, more and more are once again willing to consider looking at sponsored properties or fractional ownerships, in which a pool of investors owns a single property.

While 1031 exchanges and **tenant-in-common** ownership entities were once popular, now the **Delaware Statutory Trust** is becoming the vehicle of choice, **Evan Farahnik**, president of **ExchangePoint Properties LLC**, tells GlobeSt.com. Before the economic downturn, fractional ownerships usually involved a tenant-in-common structure, whereby under the tax rule up to 35 LLCs could invest in one property and have it be valid for an exchange. Since then, weaknesses in the TIC structure that have caused issues for some of the properties that were struggling and for some lenders.

"But another vehicle for that is the Delaware Statutory Trust, which also allows for an exchange," Farahnik says. "You can have up to 500 investors, and you don't have separate LLCs anymore, but everyone comes together into one LLC and takes advantage of the tax deferral. The profile of the properties is different in a DST; the sponsors and the investors are a lot more restricted on what they can do. Before, in the TIC structure, there was a lot of flexibility on what properties you can take to market and have sponsors invest in, but with the DST structure, the field of properties to pursue is limited to single-tenant assets or multifamily properties."

The reason why these types of assets do best in a DST structure mostly involves the resizing of units for tenants, which complicates ownership issues when there is a large number of investors. With a single-tenant asset, resizing is not needed, eliminating this complication. "The ideal type of property for a DST structure would have a single-tenant lease and credit behind it," says Farahnik.

He adds that sponsored properties are intended for wealth preservation, and the risk to investors is meant to be minimal, so long-term leases with a credit tenant help reduce or mitigate risk as much as possible.

“This is a market we’re very active in and were between ’05 and ’08,” says Farahnik. “We still manage assets for that type of investor base and are now actively looking at more acquisition opportunities as well.”

Many investors have exchanges that are several generations in, and the tax consequences would be very adverse for them, so they need to find another exchange to continue to defer the taxes, Farahnik explains. “Their investment dollar amounts usually tend to be between $300,000 and $1 million, and properties with that dollar amount wouldn’t be that great or attractive, so they look at going into larger properties on a fractional basis so that they can take advantage of a better property.”

The legal and tax-opinion fees a sponsor is required to pay are too great a percentage for lower-priced properties to be feasible investments, so properties around the $10-million value are best for sponsored properties.